

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:)	
)	
BEVERLY GRAY STEPHENSON, JR.)	Case No. 07-10778-SSM
)	Chapter 7
Debtor)	
)	
NORMAN CANFIELD)	
)	
Plaintiff)	
)	
vs.)	Adversary Proceeding No. 07-1087
)	
BEVERLY GRAY STEPHENSON, JR.)	
)	
Defendant)	

MEMORANDUM OPINION

A new trial—limited to the issue of the amount for which the defendant would have been liable as a responsible person for taxes the company he was managing was required to pay—was held on May 8, 2008. The plaintiff and the defendant were each present in person and were represented by counsel. Having considered the additional evidence and argument, the court determines that \$31,994.90 of the state court judgment against the debtor is nondischargeable.

Background

The facts underlying the plaintiff's claim were set forth in this court's memorandum opinion of November 30, 2007 (Doc. # 26) and in the oral findings of fact and conclusions of

law made at the conclusion of the trial on January 25, 2008,¹ and will be repeated only to the extent necessary to provide a context for the present ruling.

Norman's Automotive Services, Inc. ("Norman's Automotive") was owned by Norman Canfield, who entered into an agreement by which the debtor would purchase the business under a lease-purchase arrangement. The debtor took possession of the business and operated it from July 2004 through June 2005. After the debtor failed to make the required lease payments, Canfield regained control of the business in July 2005. Upon doing so, Canfield learned that over the preceding 11 months the debtor, while managing the company and in control of its checkbook, had failed to pay Federal and Virginia state withholding taxes, Social Security and medicare taxes, Virginia Employment Commission taxes, Federal unemployment taxes, and Virginia state sales taxes. Norman's Automotive made payments to the Internal Revenue Service and the Commonwealth of Virginia in the amount of \$51,411.55 on account of the taxes the debtor had not paid. Norman's Automotive then brought suit against the debtor in the Circuit Court of Fairfax County, Virginia, for breach of contract and obtained a judgment against the debtor for \$116,372.76, which included (in addition to other sums not at issue in this adversary proceeding) the \$51,411.55 in delinquent taxes, penalties, and interest that Norman's Automotive had paid to the IRS and the Commonwealth of Virginia. Norman's Automotive subsequently assigned the judgment to Canfield, who then brought this action *pro se* to determine the dischargeability of the judgment.

The theory of nondischargeability, as set forth in the amended complaint filed by the plaintiff after he obtained counsel, was that the taxes paid by Norman's Automotive were

¹ A transcript of the oral ruling has not yet been filed.

nondischargeable under § 523(a)(14) and (14A), Bankruptcy Code, as debts “incurred to pay a tax.” Although the court ruled that the cited exception to discharge did not apply to a liability arising from a breach of contract for payment of taxes as opposed to a loan of money for the purpose of paying taxes, the court also ruled that on the facts alleged, the debt for the taxes might be nondischargeable on a theory that Norman’s Automotive, when it paid the taxes, became equitably subrogated to the claims and remedies of the taxing authorities, which would have included the ability of the taxing authorities to impose a nondischargeable liability on the debtor as a responsible person. *Canfield v. Stephenson (In re Stephenson)*, 2007 WL 4268904 (Bankr. E.D. Va. 2007).

Following a trial on January 25, 2008, judgment was entered against the debtor on January 28, 2008, determining that \$42,638.63 of the state court judgment was nondischargeable as representing the nondischargeable taxes for which the debtor could have been held liable as a responsible person. *See* §§ 523(a)(1) and 507(a)(8), Bankruptcy Code. The debtor filed a timely motion for reconsideration on the grounds (1) that the evidence presented at the trial was insufficient to determine what portion of the Form 941 taxes represented trust fund liabilities for which the debtor could have been held liable by the tax authorities, and (2) that a responsible person assessment extends only to the unpaid taxes and does not include the penalties and interest. The court treated the motion as one for a new trial and granted it, limited to the issue of the amount of the taxes for which the defendant would have been liable to the tax authorities as a responsible person.

At the trial, evidence was presented to show that the following taxes, penalties, and interest had been paid by Norman's Automotive on account of taxes the debtor had not paid while he was in control of the business:²

Virginia withholding taxes	\$5,632.65
Virginia sales taxes	\$4,281.94
Trust fund portion of 941 taxes ³	\$22,080.31
Non-trust fund portion of 941 taxes ⁴	\$10,124.19
Federal unemployment taxes (Form 940)	\$352.41
State unemployment taxes (VEC)	\$475.39
Federal corporate income taxes	\$105.03
Form 941 penalties and interest	\$6,535.40
Form 940 penalties and interest	\$92.41
Virginia penalties and interest	\$1,731.83

Conclusions of Law and Discussion

In originally reaching a determination as to what portion of the Form 941 liabilities paid by Norman's Automotive represented trust fund liabilities (that is, the income tax withholding and the employees' share of Social Security and Medicare), the court, in the absence of the actual returns that would have supported a more accurate breakdown, estimated the trust fund portion at 80% of the Form 941 liabilities. That figure, as it turns out, was somewhat high (the

² A chart correlating the breakdown to the actual checks is attached as an exhibit to this opinion.

³ The "trust fund" portion of the Form 941 taxes consist of income tax withheld from employees' pay and the employee's share of the Social Security and Medicare taxes.

⁴ The "non-trust fund" portion of the Form 941 taxes consist of the employer's share of the Social Security and Medicare taxes.

actual ratio being closer to 69%). Additionally, the court agrees with the defendant that the trust fund liability properly includes only the unpaid tax, and not the penalties and interest. The court rejects the debtor's argument that the taxes represented by check No. 5398 did not arise during the period he had control of the business. The finding of the state court that they did is conclusive, and this court's only function is to determine what portion represents trust fund liabilities. Accordingly, the court determines that the nondischargeable trust fund liabilities to which Norman's Automotive is subrogated totals \$31,994.90. as follows:

Virginia withholding taxes	\$5,632.65
Virginia sales taxes	\$4,281.94
Trust fund portion of Federal Form 941 taxes	\$22,080.31
Total	<u>\$31,994.90</u>

An amended judgment will be entered consistent with this opinion.

Date: _____

Alexandria, Virginia

Stephen S. Mitchell

United States Bankruptcy Judge

Copies to:

Mark E. Sharp, Esquire
Culin, Sharp, Autry & Day, P.L.C.
4124 Leonard Drive
Fairfax, VA 22030
Counsel for the plaintiff

Bennett A. Brown, Esquire
The Law Office of Bennett A. Brown
3905 Railroad Avenue, Suite 200N
Fairfax, VA 22030
Counsel for the defendant

Summary of Tax Payments

<u>Ck #</u>	<u>Va withholding</u>	<u>Va sales tax</u>	<u>941 Trust Fund</u>	<u>941 Non-trust Fund</u>
5014	\$ 1,789.50			
5015		\$2,160.56		
5016			\$ 4,694.59	\$ 2,137.93
5017			\$ 3,807.27	\$ 1,676.27
5032	\$ 508.52			
5033	\$ 577.48			
5034	\$ 477.71			
5035			\$ 2,028.54	\$ 846.58
5036		\$ 770.09		
5039		\$ 345.37		
5046		\$ 363.85		
5101			\$ 4,200.74	\$ 2,168.37
5102			\$ 411.70	\$ 265.03
5103				
5104				
5105				
5106				
5107	\$ 489.48			
5108	\$ 511.11			
5109	\$ 461.41			
5110	\$ 233.49			
5111		\$ 362.77		
5112		\$ 279.30		
5134				
5148				
5191				
5192				
5193				
5223				
5224				
5226				
5227				
5228				
5229				
5230				
5231				
5232				
5233				
5234				
5235				
5262				
5296				
5296				
5296				
5300				
5342				
5459				
5398			\$ 6,937.47	\$ 3,029.87
5399				
5400	\$ 584.25			
5401				
Totals	\$ 5,632.65	\$4,281.94	\$22,080.31	\$10,124.19

<u>Ck #</u>	<u>Form 940</u> <u>(FUTA)</u>	<u>VEC</u>	<u>Fed. Corp</u>	<u>941 Penalty</u>	<u>940 Penalty</u>	<u>Va penalty</u>
5014						
5015						
5016						
5017						
5032						
5033						
5034						
5035						
5036						
5039						
5046						
5101						
5102						
5103	\$ 296.41					
5104		\$ 95.66				
5105		\$ 83.13				
5106		\$ 30.00				
5107						
5108						
5109						
5110						
5111						
5112						
5134				\$2,728.25		
5148		\$ 225.00				
5191				\$ 74.11		
5192					\$ 92.41	
5193				\$1,957.94		
5223						\$ 193.31
5224						\$ 194.25
5226						\$ 119.63
5227						\$ 184.90
5228						\$ 81.34
5229						\$ 85.83
5230						\$ 164.45
5231						\$ 72.62
5232						\$ 131.22
5233						\$ 90.78
5234						\$ 63.15
5235						\$ 36.42
5262				\$1,775.10		
5296						\$ 48.57
5296						\$ 22.84
5296			\$ 105.03			
5300						\$ 122.68
5342						\$ 83.34
5459						\$ 36.50
5398						
5399	\$ 56.00					
5400						
5401		\$ 41.60				
Totals	\$ 352.41	\$ 475.39	\$ 105.03	\$6,535.40	\$ 92.41	\$1,731.83